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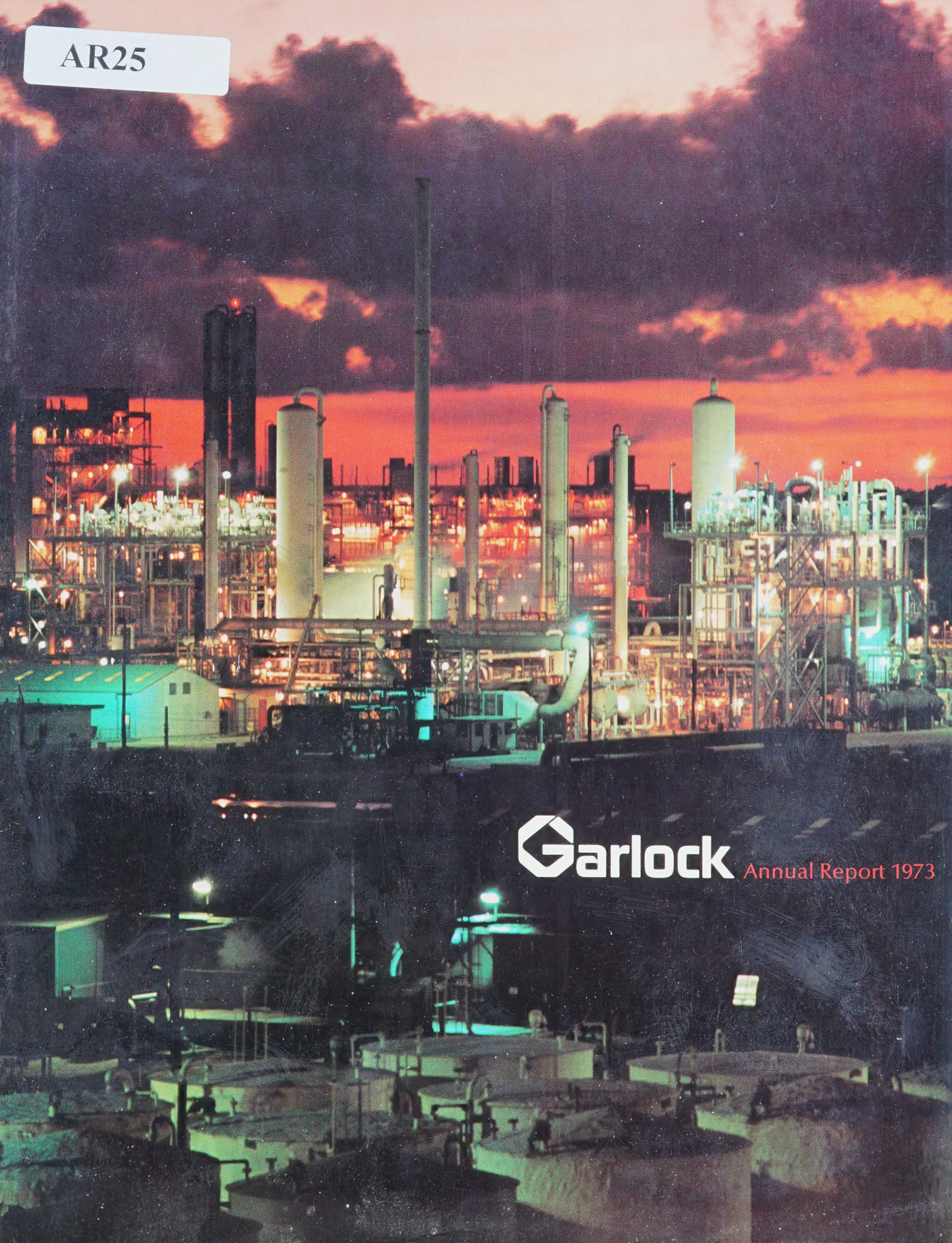


Garlock Annual Report 1973

Garlock's Business

Garlock was organized in 1887 to manufacture mechanical packings which seal or control leakage. Through acquisition and internal product development, the company now makes other industrial components. Substantially all of these are related to the basic sealing business by function, manufacturing technology, marketing or a combination of these.

Products are composed of various combinations of rubber, metal, textiles, leather, chemicals and plastic. The majority of these products wear out and must be replaced during the life of the equipment in which they are installed. This feature makes Garlock resistent to fluctuations in the economy.

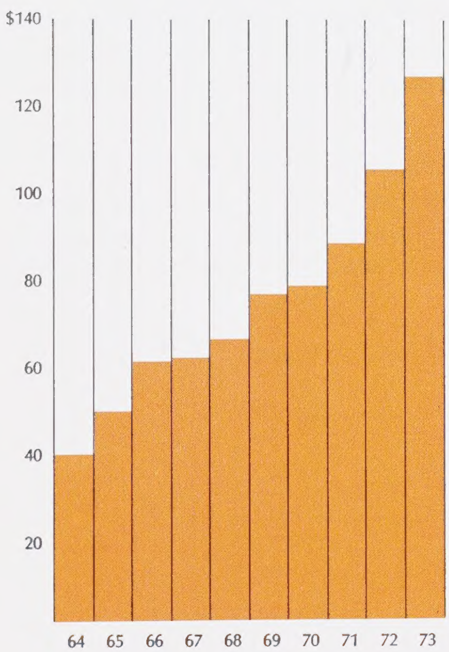
In a growing economy, a greater portion of Garlock sales are to new equipment manufacturers. When the economy slows, aftermarket sales are higher. Over the long term, sales are evenly divided between new equipment makers and the aftermarket.

Customers are in all major industries, but they are primarily machinery and transportation equipment makers and users. Sales are through company salesmen, manufacturers' representatives, and independent distributors in more than 80 countries. Garlock operates 15 plants in the United States and 13 in Belgium, France, England, Mexico, Australia, Spain, Japan and Canada.

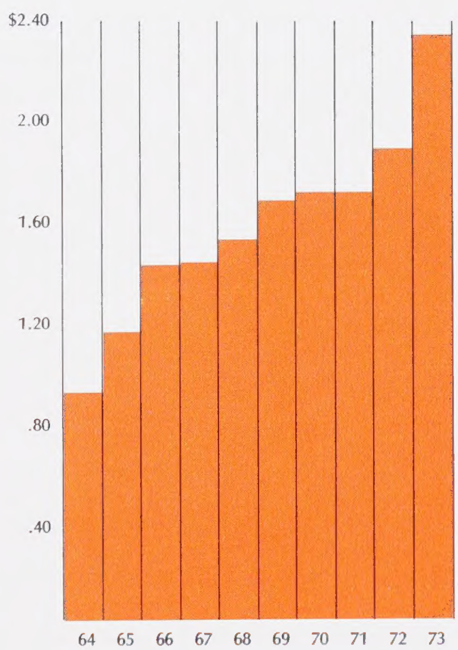
Financial Highlights

	1973	1972	Change
Sales	$126,022,000	$105,159,000	+20%
Net Income	5,592,000	4,513,000	+24%
Net Income Per Share	2.35	1.90	+24%
Dividends Per Share	$.84	$.81	+ 4%
Average Shares Outstanding	2,377,000	2,380,000	—

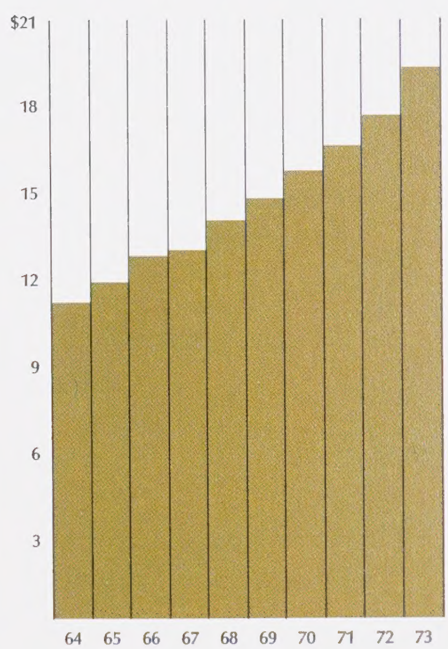
Sales
(In Millions)



Earnings Per Share



Shareholders' Ownership Per Share



A. J. McMullen B. H. Cook

Letter to Shareholders Garlock again established record sales and earnings in fiscal 1973. Net income has grown each year since 1961—through several periods of recession in the United States and elsewhere around the world where we operate. We are proud of this performance.

In the 52 weeks of 1973 net income rose 24% on a 20% sales gain over the 53 weeks of 1972, showing our ability to take advantage of the economics inherent in higher production levels and to eliminate some of our less profitable products and operations.

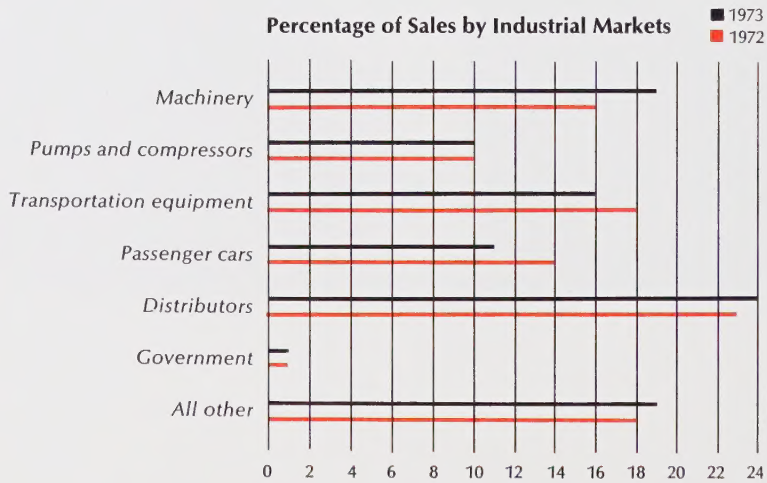
Sales of $126,022,000 in 1973 and $105,159,000 in 1972 produced net income of $5,592,000 in 1973 and $4,513,000 in 1972.

Earnings per share rose 24% to $2.35 from $1.90 in 1972, with a similar number of common shares outstanding in both years.

Approximately 50% of our 1973 revenues was derived from sales to original equipment manufacturers. The other half of our business was with distributors and other customers for maintenance, repair and additional operating supplies.

All segments of our business experienced increases with the exception of shipments to the automotive (passenger car) industry where revenues declined to 11% of the total in 1973 compared to 14% in 1972. This trend is the direct result of the implementation of programs designed to reduce our dependence on cyclical industries. At the same time we are maintaining a strong technological base in the passenger car industry.

Revenues and profits outside the United States continued to grow substantially. To further capitalize on our European growth in the Benelux countries (Belgium, the Netherlands and Luxembourg) and in



Spain late last year, Garlock organized two marketing organizations in Sliedrecht (the Netherlands) and Barcelona (Spain). They should contribute to further increases in our exports to these areas.

All of the growth experienced in 1973 in both sales and earnings was internally generated through better and expanded market penetration together with the development of new and improved product lines.

Facilities expansions were completed at our Plastics Division in New Jersey, our Fluid Power Limited subsidiary in Canada, our two Woodville plants in the United Kingdom, our Service Spring subsidiary in Indiana, and our Stemco subsidiary in Texas to accommodate continued growth in their products. In addition, we established a facility in Canada for the limited production and assembly of Stemco® heavy truck maintenance products.

In 1973 we sold our Alling-Lander Division which manufactured power transmission equipment and custom gears. Since acquiring this business in 1968, we had been unable to develop or acquire additional product lines to form an economically viable base for future growth.

In October 1973 the Court of Appeals for the Second Circuit rendered an adverse decision in our suit against the Commissioner of Internal Revenue on a technical point of tax law involving the income of an affiliate, Garlock, S.A., for the years 1964-65. In 1972 the Tax Court decided against us and determined federal tax deficiencies against Garlock Inc. for those years. The amounts including interest are immaterial. We are petitioning the United States Supreme Court to review the Court of Appeal's decision.

As indicated in Note 1 to the Financial Statements foreign currency translation had no material effect on Garlock's income or financial position. We did retain a small reserve at year end which should prevent adverse effects on our earnings as a result of the continued decline in foreign currency values in early 1974.

Much has been written in the press regarding additional disclosure of financial data required by the Securities and Exchange Commission. We believe that this 1973 Annual Report contains all of the information a shareholder would want, but copies of our detailed 10-K Annual Report to the S.E.C. will be available in April, upon request.

The 1974 business climate is uncertain, primarily owing to shortages of energy and other materials. Because of necessary plant expansion and possible inventory accumulation, we anticipate spending by industry will increase in 1974.

While such major sectors as home building as well as appliances and automobile manufacturing will probably operate at levels below those achieved in 1973, the machinery, iron and steel, pulp and paper and petro-chemical industries should demonstrate continued growth in 1974. Electrical utilities and mining industries are also expected to show a marked increase in capital spending. Petroleum companies have already indicated that they will substantially increase refinery capacity.

In the future, industry will be increasingly affected by raw material shortages. These shortages will challenge the ability of industrial managers to find alternate materials, to reschedule production if delays occur, and to deliver products on time. Because of our past success in handling similar problems, we are confident that Garlock will cope with these new challenges.

In the pages that follow we have listed some of the questions commonly asked of us during the year and our answers. If you desire additional information on our operations, please write to us.

A McMullen	B. H. Cook
Chairman of the Board *Chief Executive Officer*	*President* *Chief Operating Officer*

February 25, 1974

What is Garlock's ranking within American industry?

According to *Fortune* magazine, Garlock ranked 759 among the top 1,000 U.S. industrial companies in terms of 1972 sales volume, but it was listed 197 in earnings per share growth for 1962-1972.

In terms of combined return to investors, which includes both price appreciation and cash payouts, Garlock ranked 186 in the 1,000, with investors realizing an average combined return of 16.69% over the 10-year period.

Has the energy crisis affected Garlock?

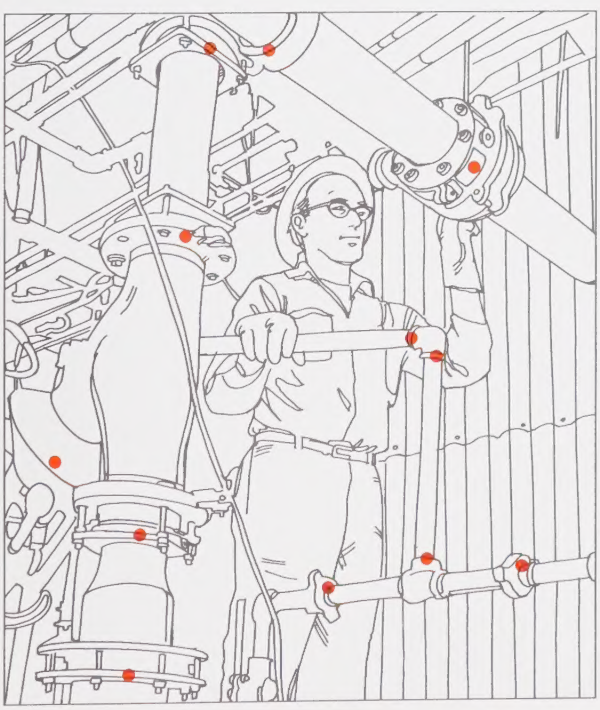
Internally the effect has been negligible. Externally, our customers have experienced considerable changes, but these will not necessarily affect our operations. It's still too early to know how the energy problem will affect incoming orders.

Shipments of raw materials to Garlock and, therefore, finished products to customers have occasionally been delayed by fuel shortages.

So far Garlock's major plants have adequate fuel supplies on hand. For example, the Mechanical Rubber Division's power plant, which generates its own steam and electricity, maintains a two months coal supply with commitments through 1974.

Like homeowners and other industries, we are taking conservation measures. Typical of these efforts is our program to phase-out full-sized cars from our salesmen's fleet and to substitute intermediate or compact sizes.

A substantial number of Garlock products have a sealing function in piping systems of chemical, petroleum and petrochemical facilities.



What is the impact of federal price controls on Garlock and its customers?

Although Garlock has been for the most part successful in passing along its cost increases to its customers in accordance with federal regulations, we have noted many distortions in the world marketplace that controls have caused. The controls have interfered with the supply and demand forces which in a free enterprise system ordinarily govern the allocation of goods and services. The removal of all federal price controls will be a big step toward ending the present market distortions.

What effects have materials shortages had on Garlock and where have they been most evident?

Although materials shortages have temporarily affected almost all Garlock operations, none has become critical. The most significant shortages noted in 1973 were in mixing catalysts for making rubber and in specialty steel. Some elastomers are in short supply and leather continues to be limited. In 1974 other shortages will likely occur, and we are constantly looking for alternate materials.

Are any major price increases planned in 1974?

We have already made some increases and contemplate additional increases before the end of price controls. These

Photo courtesy of Republic Steel Corporation.

will offset rapidly rising costs of raw materials; and for this reason, they are and will be in compliance with the currrent Economic Stabilization Program. The price controls are scheduled to expire at the end of April.

Competition is still the major factor in determining prices. Where competitive conditions and government regulations permit, we will continue to seek price increases which will enable us to maintain or improve our profit margins.

In the 1971 annual report, Garlock projected a 15% compounded annual growth rate in sales through 1975. Is that projection still valid?

We are ahead of that projection now. Through 1973 our compounded annual growth rate in sales since 1971 has been 20%. Actual or anticipated shortages of labor, materials and fuel will probably not permit us to maintain this pace in 1974. The demand for our products in 1974 and 1975 will moderate somewhat, but will continue its upward momentum because of the combined needs of key O.E.M. industries and the broader aftermarket. We feel that 15% average growth during the 1971-1975 period is still a valid objective.

Do Garlock's diversified products and raw material requirements warrant computerized inventory control?

More than half of Garlock's inventory now is directly or indirectly computerized. The "Brain" of the centralized/decentralized system is an IBM 370/135 computer located at our corporate administrative center in Palmyra, New York. It is assisted by five Systems 3 data processors, or mini-computers, located in North Carolina, Texas, Canada, England and New York.

Some locations in the system now use random batch processing from remote locations, but the cost of world, or even national, transmission line leasing makes on-line or direct-contact processing impractical in the foreseeable future.

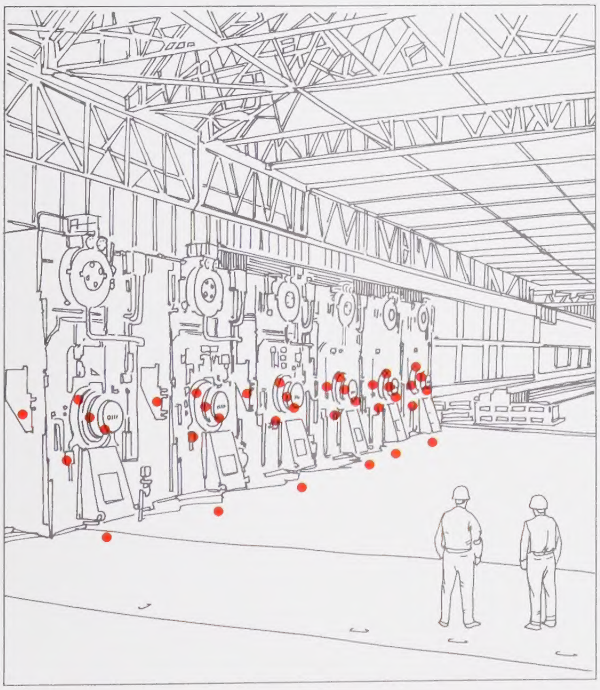
Locations not using the computer system control their inventory by a manual, perpetual inventory system which has proved effective for these generally smaller operations. They will be included in the computer system when they are large enough to use it economically.

What is the prospect for establishing a consumer market for Garlock's coatings or any other product?

Our coatings products seem to be suitable for introduction into consumer markets. However, we have not yet developed this business in industrial markets to our satisfaction.

We do not now have any other products appropriate for consumer markets, nor have we any expertise in marketing to consumers. Accordingly, the likelihood of consumer marketing for any Garlock products is remote.

Steel mills use substantial gasketing, packings, oil seals and other Garlock products.

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During 1973 which product areas showed the greatest strength and weakness?

Polyurethane and TFE (best known by the duPont Company's trademark Teflon) products have gained most in volume. Packing products, heavy-truck products, hydraulic-pneumatic products, and power-transmission products have done particularly well in 1973 and in the year to date.

The only disappointment in 1973 was the inability of the new coatings business to grow as fast as we had planned. Because of our coatings' exceptional technical performance and Garlock's strong marketing position, we expect to correct this situation soon.

Is Garlock planning to increase its sales growth outside the United States?

Because industrialization is occurring at a faster rate outside the United States than it is here, management feels that it is logical to take advantage of this situation. We expect to grow faster abroad than in the United States.

Do Garlock's overseas operations reduce jobs in the United States?

No. Garlock's expanding overseas marketing organization has required an increasing amount of exports which require domestic labor content. In this sense, our overseas operations create or preserve jobs in the United States.

Seldom do we have a real choice as to whether to manufacture a particular product in the United States or abroad. Although the availability and cost of labor obviously are essential factors in determining plant locations, such decisions are based primarily on service considerations. When we do decide to manufacture abroad rather than in the United States, one result normally is a transfer of technology to the United States, which benefits our domestic employment as well as that abroad.

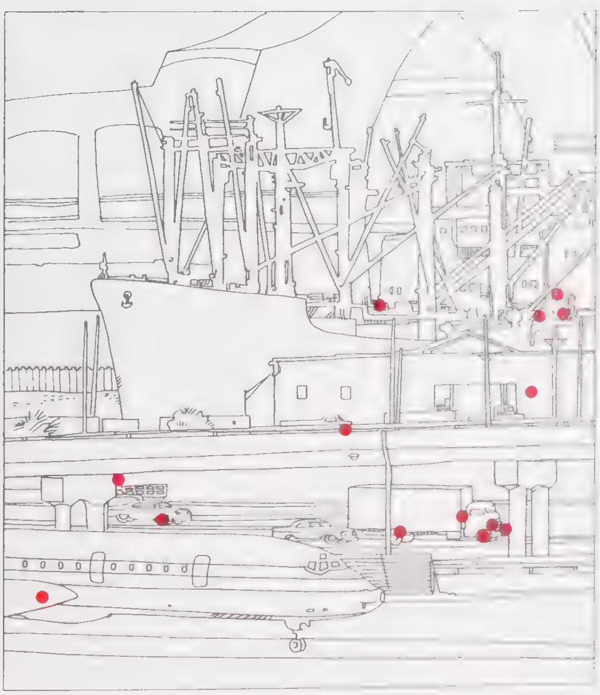
Are there any major labor contracts which end in 1974 and will their renegotiation have any impact on 1974 operating results?

Garlock has traditionally maintained an excellent employee relations record. The only major collective bargaining agreement expiring in 1974 was at the Mechanical Rubber Division. In January it was equitably renegotiated for one year with no significant impact on 1974 operating results.

Why doesn't Garlock have an automatic dividend reinvestment program?

Management has contacted several banks which are capable of administering such a program for Garlock. Their experience with automatic dividend reinvestment programs for other companies indicates that a relatively few shareholders with a relatively small percentage of the shares outstanding tend to participate, and that as a result such

The transportation portion of Garlock's business includes trucks, trains, cars, ships and planes.



programs tend to be advantageous only for companies with more shareholders and shares outstanding than Garlock. To initiate such a program at this time would be premature.

Which product areas will be expanded either internally or through acquisitions?

Primarily those industrial products relating to our present manufacturing or marketing expertise. These products are engineered components which usually require replacement during the life of the equipment in which they are installed. Some of the products we are considering are other specialty valves, compressor components, specialty coatings, sleeve bearings, and replacement parts for heavy trucks.

What progress has Garlock's acquisition program made this year and last?

Several acquisitions are currently being contemplated, but none is of substantial size. Last year we made no significant acquisitions.

What are the objectives of your acquisition program?

If a company's products are compatible with ours, we will consider the acquisition of a company with sales as small as $1 million. If a company's products are not related to existing Garlock products, but fit one of our existing industrial markets, the sales of the potential acquisition would have to be greater than $5 million.

Describe Garlock's research and development program.

New products are developed more by evolution than revolution, occurring primarily in response to customers' requirements. We spend an estimated 1% of sales on product development, research and engineering. This figure can be misleading as our customers often pay us additional amounts for specific development programs of interest to them.

What are your future capital expenditures likely to be?

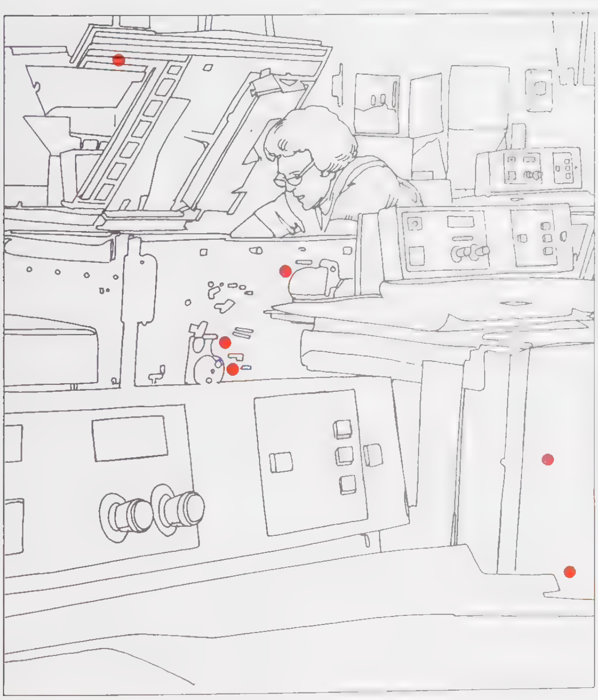
Capital expenditures for maintaining or upgrading existing plants and equipment have ranged between 150 and 200% of depreciation in recent years. We expect this pattern to continue.

More than $6 million has been budgeted for capital expenditures (property, plant, equipment, etc.) in 1974. This figure compares to the $5.8 million spent in 1973. The extent to which this budget will be implemented depends on the strength of the economy.

How will capital expenditures be financed?

Our cash flow from depreciation and retained earnings should be sufficient as in the past to maintain the existing plants and equipment. Expansion of present capacity will require additional amounts of long-term debt or equity.

The best known office copier manufacturer uses Garlock components to move paper, contain toner powder, and control other functions.



What are Garlock's financing possibilities in 1974 and in future years?

Arrangements were made in early 1973 when rates were favorable for additional long term debt in 1974 which is adequate for our present plans.

With interest rates now at historically high levels, external financing through debt is expensive, even though a substantial portion of our debt is under long term financing agreements at more favorable rates than apply to our short term bank borrowings.

Because of the present state of the securities markets wherein Garlock stock is selling at close to its lowest historical price earnings ratio, the Garlock board of directors feels that it is inappropriate to sell more common stock now.

When and if Garlock's stock value rises to more equitable levels relative to securities markets and its earnings, or when Garlock's equity needs intensify, which will not be likely for several years, the board will consider external financing in the form of equity.

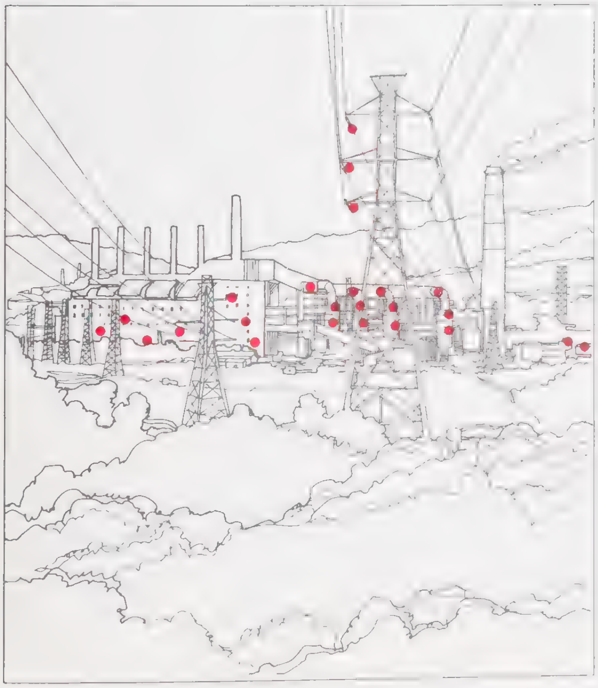
What do you expect Garlock's 1974 interest expense will be?

Because most of our borrowings are under long standing agreements, our interest expense will not fluctuate significantly in 1974. Short term bank borrowings may fluctuate, but we anticipate interest expense of about $2 million in 1974, compared to $1.9 million last year.

What debt to equity ratio does Garlock consider appropriate?

Our philosophy regarding leveraging with debt is to maximize the potential of our shareholders' capital without sacrificing safety. We think this philosophy is best represented by a capital structure containing two-thirds equity and one-third debt.

Electrical power plants' boiler room piping, cooling systems and exhaust systems contain substantial numbers of Garlock products.



Describe Garlock's management.

The average age of Garlock's officers is 52 years; their average length of service is 20 years. The senior management ranks are relatively small, compared to other nationally prominent companies, and are adequately supported by a strong, young, middle management team. This management organization makes administration more expedient and more flexible with less overhead expense.

What has happened to Garlock's important operations in Great Britain due to the general labor strife there?

At the end of February, the main plant of our subsidiary, Woodville Rubber Co. Limited, was operating on a 5-day work week with full shifts while the smaller plant was on 3-day shifts. Their sales for the first six weeks of this year were substantially ahead of 1973 at this time. The main Woodville plant has a power generator which can produce part of its electricity requirements so it need not rely wholly upon public power sources.

Because a substantial portion of these plants' output is sold to the European continent and elsewhere in the British Commonwealth, the economic condition of Woodville's customers in the United Kingdom has less effect on Woodville's operations than if all of its sales volume depended on British customers.

What is Garlock's competition?

No other public company is directly comparable to Garlock. Competition in one or more markets comes from divisions of other corporations (some of these corporations are much larger than Garlock) or from single product line companies, much smaller than Garlock. Competition is, therefore, fragmented and not simple to analyze.

At what capacity levels have Garlock plants been operating in recent months?

At year end Garlock plants were operating at an estimated 80% of theoretical capacity, or 90% of practical capacity. Production levels have not varied noticeably since the dramatic volume increase in the fourth quarter of 1972. These figures do not include the capacity expansions covered in the Letter to Shareholders.

Several Garlock plants manufacture many different products and, therefore, must retool between jobs and/or use different materials for succeeding jobs. Such diversity adds to production downtime, but this inherent product and market diversity also helps to explain Garlock's growth and strength in past economic downturns. Where it is practical, we have decreased downtime considerably by installing modern, numerically controlled machinery.

What is Garlock's dividend policy?

A recent survey of our shareholder body indicates that the majority of Garlock investors are looking for a combination of capital gains and cash dividends. To satisfy these objectives, Garlock management is determined to increase earnings per share so as to permit commensurate increases in cash dividends and to warrant a higher evaluation of Garlock stock in the marketplace.

As to the percentage of dividend payout, our policy has been, and will remain, to reinvest in the business a larger portion of our earnings than is paid out in dividends. Naturally we hope to increase earnings fast enough to permit consistent dividend increases.

Form 10-K The Form 10-K Annual Report to the Securities and Exchange Commission provides certain additional information and will be available in April. A copy of this report may be obtained upon request.

Statement of Consolidated Income and Retained Earnings

GARLOCK INC. AND CONSOLIDATED SUBSIDIARIES

Income

	52 Weeks Ended December 30, 1973	53 Weeks Ended December 31, 1972
Net Sales and Operating Revenues	$126,021,620	$105,159,348
Operating costs:		
Cost of goods sold	84,236,839	70,898,827
Selling and administrative expenses	28,149,560	24,737,233
Total operating costs	112,386,399	95,636,060
Income from operations	13,635,221	9,523,288
Sundry charges—net	2,576,357	1,447,577
Income before taxes on income	11,058,864	8,075,711
Taxes on income	5,467,230	3,562,684
Net Income for the Year	$ 5,591,634	$ 4,513,027
Average shares outstanding	2,376,929	2,379,532
Earnings Per Share	$ 2.35	$ 1.90

Retained Earnings

	52 Weeks Ended December 30, 1973	53 Weeks Ended December 31, 1972
Retained Earnings, beginning as previously reported	$ 33,843,082	$ 30,418,181
Acquisition of company accounted for as a pooling of interests (Note 2)	—	865,236
Retained Earnings, beginning as restated	33,843,082	31,283,417
Net income for the year	5,591,634	4,513,027
Other	—	(61,913)
Dividends:		
Garlock Inc. (1973—$.84; 1972—$.81)	(1,996,604)	(1,849,226)
Pooled company prior to acquisition	—	(42,223)
Retained Earnings, ending	$ 37,438,112	$ 33,843,082

See notes to financial statements.

Statement of Consolidated Financial Position

GARLOCK INC. AND CONSOLIDATED SUBSIDIARIES

	December 30, 1973	December 31, 1972
Current Assets:		
Cash and marketable securities	$ 1,880,175	$ 1,321,120
Accounts receivable (Less allowance: 1973—$321,899; 1972—$244,489)	21,745,930	18,000,714
Inventories (Note 4)	31,510,041	26,028,306
Prepaid expenses	915,112	908,218
Total current assets	56,051,258	46,258,358
Less Current Liabilities:		
Notes payable and current portion of long-term debt (Note 5)	6,223,023	5,872,924
Accounts payable and accrued expenses	11,818,420	9,382,973
U.S. and Foreign taxes on income	2,657,771	1,349,912
Total current liabilities	20,699,214	16,605,809
Working Capital	35,352,044	29,652,549
Other Assets:		
Property, plant and equipment (Note 3)	28,224,361	27,040,852
Deferred charges, sundry investments	2,079,032	946,544
Excess of investment in subsidiaries over book value of net assets	5,762,029	5,768,552
Total other assets	36,065,422	33,755,948
Assets Less Current Liabilities	71,417,466	63,408,497
Less Other Liabilities:		
Long-term debt (Note 5)	19,923,641	16,989,298
Deferred taxes on income and other credits	940,819	491,610
Other liabilities	2,600,326	2,070,210
Total other liabilities	23,464,786	19,551,118
Excess of Assets Over Liabilities	$47,952,680	$43,857,379
Shareholders' Ownership (Notes 5 and 6):		
Minority interest in subsidiaries	$ 2,306,290	$ 1,813,925
Garlock Inc. shareholders:		
Preferred stock (authorized 300,000 shares of $1 par value each, undesignated; issued, none)	—	—
Common stock (authorized 5,000,000 shares of $1 par value each; issued: 1973—2,415,444; 1972—2,415,444 shares)	2,415,444	2,415,444
Excess of shareholders' investment over par value of common stock	6,446,108	6,447,627
Retained Earnings	37,438,112	33,843,082
	46,299,664	42,706,153
Less treasury stock at cost (1973—38,135 shares; 1972—38,685 shares)	653,274	662,699
Total ownership—Garlock Inc. shareholders (Outstanding: 1973—2,377,309 shares; 1972—2,376,759 shares)	45,646,390	42,043,454
Total	$47,952,680	$43,857,379

See notes to financial statements.

Statement of Changes in Consolidated Financial Position

GARLOCK INC. AND CONSOLIDATED SUBSIDIARIES

	52 Weeks Ended December 30, 1973	53 Weeks Ended December 31, 1972
Sources of Funds		
From operations:		
Net income	$ 5,591,634	$ 4,513,027
Depreciation and amortization	2,918,128	2,713,303
Deferred income taxes	359,259	210,704
Pension expense	500,000	502,535
Minority interest in net income	254,127	148,267
(Gain) loss on disposition of property, plant and equipment	17,305	(248,322)
Other—net	30,116	(70,234)
Total from operations	9,670,569	7,769,280
Decrease in deferred charges and sundry investments	—	459,331
Sales and retirement of property, plant and equipment	432,138	497,744
Sale and issuance of treasury stock	7,906	21,562
Increase in long-term debt	6,878,457	5,082,459
Other increases in minority interest	238,238	—
Increase in other credits	89,949	—
Total sources	$17,317,257	$13,830,376
Dispositions of Funds		
Cash dividends	$ 1,996,604	$ 1,891,449
Acquisition of property, plant and equipment	4,544,557	5,161,528
Purchase of treasury stock	—	225,862
Increase in deferred charges and sundry investments	1,132,488	—
Reduction in long-term debt	3,944,113	1,089,499
Excess of investment in acquisitions over book value of net assets	—	268,530
Acquisition of minority interest	—	43,022
Other dispositions—net	—	118,981
Increase in working capital	5,699,495	5,031,505
Total dispositions	$17,317,257	$13,830,376
Changes in Working Capital Components		
Current assets:		
Cash and marketable securities	$ 559,055	$ (1,865,096)
Accounts receivable	3,745,216	3,454,964
Inventories	5,481,735	4,948,528
Prepaid expenses	6,894	26,443
Increase in current assets	9,792,900	6,564,839
Current liabilities:		
Notes payable and current portion of long-term debt	350,099	(157,781)
Accounts payable and accrued expenses	2,435,447	1,187,094
U.S. and Foreign taxes on income	1,307,859	504,021
Increase in current liabilities	4,093,405	1,533,334
Increase in working capital	$ 5,699,495	$ 5,031,505

See notes to financial statements.

1 Accounting Policies

A summary of the significant accounting policies followed by the Company in preparation of the accompanying consolidated financial statements is set forth below:

Basis of Consolidation: The Company follows the practice of consolidating all subsidiaries except in unusual circumstances. All material intercompany balances and transactions have been eliminated.

Currency Translation: The Company follows the monetary/non-monetary approach in valuing foreign assets and liabilities in all material respects. Transactions during the period are translated at the average rate prevailing during the period and revaluation of monetary assets and liabilities arising at the time of currency change are reflected as increases or decreases in earnings after establishment of reserves for anticipated future changes. The effect on income and the reserves established have not been material.

Research and Development Costs: The Company has not engaged in any major research and development programs. Development work is primarily of an applications and material evaluation nature and is charged against income as incurred.

Lease Purchase Agreements: Agreements for the leasing of plant and equipment are treated in conformity with Accounting Principles Board Opinion No. 5 and all installment purchases are reflected as long-term liabilities with the related property capitalized. See Note 8 for disclosures required by Accounting Principles Board Opinion No. 31.

Property, Plant and Equipment: Property, plant and equipment are carried at cost. Depreciation for financial reporting purposes is computed principally under the straight-line method and under accelerated methods for tax purposes where practical.

Maintenance and repairs are charged to expense as incurred. Renewals and replacements of a routine nature are charged to expense while those which improve or extend the life of existing properties are capitalized. The cost and related accumulated depreciation of items sold or

retired are removed from the accounts with any resulting gain or loss being included in operations for the period.

Income Taxes: Provisions for income taxes are based on the tax effects of transactions which are included in the determination of pre-tax accounting income with appropriate recognition made for deferred income taxes. No provision has been made for additional taxes that might result from the distribution to the Company of retained earnings of consolidated foreign subsidiaries inasmuch as a substantial portion of these retained earnings has been reinvested in the foreign operations. See Note 9.

The U.S. investment tax credits are applied to reduce the provision for income taxes for the year in which the related properties are acquired ("flow through" method).

Inventories: Inventories are stated generally at the lower of average cost or market.

Intangibles: The excess of investment in subsidiaries over book value of net assets consists of:

a) Goodwill purchased prior to November 1, 1970, which is amortized only when management believes that there has been a diminution in value.
b) Goodwill purchased after October 31, 1970, which is being amortized as mandated by Accounting Principles Board Opinion No. 17.

Charges or credits to income have not been material in any year.

Pensions: The Company's policy is to fund pension costs based on recommendations of its consulting actuaries.

2 Acquisitions

The Company made no material acquisitions in 1973. On August 30, 1972 the Company issued 130,864 shares of previously unissued common stock in exchange for all of the outstanding common stock of Service Spring Company. The acquisition has been accounted for as a pooling of interests and accordingly, Service Spring's net sales ($1,930,000) and net income ($199,000) for the eight months ended August 31, 1972 is included in the 1972 Statement of Consolidated Income and Retained Earnings.

3 Property, Plant and Equipment

The major classifications of property are as follows:

	1973	1972
Land	$ 1,581,020	$ 1,527,743
Buildings and improvements	14,904,508	14,695,012
Machinery and equipment	38,894,447	36,298,383
Total	55,379,975	52,521,138
Less accumulated depreciation	27,155,614	25,480,286
Net property	$28,224,361	$27,040,852

Depreciation and amortization charged to operations were as follows:

1973—$2,918,128
1972—$2,713,303

4 Inventories

Inventories reflect the following classifications:

	1973	1972
Finished, semi-finished and in process...	$23,757,157	$20,742,010
Raw materials and supplies............	7,752,884	5,286,296
Total	$31,510,041	$26,028,306

5 Long-Term Debt

Long-term debt consists of the following:

	1973	1972
7.90% (effective average rate) Notes payable to insurance company in installments to 1988................	$16,400,000	$10,800,000
8.38%–1973; 7.56%–1972 Note payable to bank under a revolving credit agreement expiring in 1977............	1,505,000	1,505,000
6.00% Note payable to bank under a revolving credit agreement expiring in 1977....................	—	3,300,000
5.50% to 6.00% Real Estate mortgages payable in installments to 1993.........	945,878	1,041,789
Other	1,072,763	342,509
Total	$19,923,641	$16,989,298

The notes payable to the insurance company contain certain restrictions on dividends. The retained earnings free of restrictions at December 30, 1973, were $5,100,000 and $4,463,000 at December 31, 1972. Total interest expense was $1,871,000 and $1,510,000 for 1973 and 1972 respectively.

6 Stock Options

At December 30, 1973, 72,950 shares of common stock were reserved for issuance under the Company's stock option plan. Of these shares, 71,450 were reserved against outstanding options ranging in price from $13.69 to $21.88. These options expire at various dates from July 23, 1975 to December 18, 1978. Options were exercisable with respect to 34,575 shares. During 1973, options for 550 shares were exercised at a price of $14.38 and aggregated $7,906, and six options with respect to an aggregate of 10,000 shares were cancelled.

At December 31, 1972, 76,500 shares of common stock were reserved for issuance under the Company's stock option plans. All of these shares were reserved against outstanding options ranging in price from $14.38 to $23.25. These options were to expire at various dates from November 1, 1973 to November 29, 1977. Options were exercisable with respect to 57,750 shares. During 1972, options for 1,500 shares were exercised at a price of $14.38 and aggregated $21,562.

7 Pension Plans

Total pension expense was $608,000 and $489,000 in 1973 and 1972 respectively. Past service cost has been fully provided and funded in prior years.

8 Rent Expense and Lease Commitments

Rent expense amounted to $1,335,000 in 1973 and $1,046,000 in 1972. Rentals on noncapitalized financing leases included in these amounts were $426,000 and $360,000 in 1973 and 1972 respectively.

The approximate minimum rental commitments under noncancellable leases, principally real estate, are as follows:

	Total	Financing Leases	Other Leases
1974	$ 1,174,000	$ 487,000	$ 687,000
1975	903,000	501,000	402,000
1976	803,000	487,000	316,000
1977	630,000	370,000	260,000
1978	387,000	219,000	168,000
1979-1983	967,000	741,000	226,000
1984-1988	634,000	575,000	59,000
1989-1993	658,000	575,000	83,000
1993 and beyond	8,855,000	8,855,000	—
Total	$15,011,000	$12,810,000	$2,201,000

Included above are minor amounts of financing and other leases for machinery and motor vehicles.

There would not have been a significant effect on the accompanying financial statements if the financing leases shown above had been capitalized.

9 Income Tax Expense

Deferred taxes relating to timing differences included in the provisions for income taxes totaled $359,000 and $211,000 for 1973 and 1972 respectively.

In accordance with the Company's policy (See Note 1) no income taxes have been provided on the undistributed earnings of foreign subsidiaries. The amount of such undistributed earnings totaled approximately $11,042,000 and $9,400,000 at the end of 1973 and 1972 respectively. If for some reason not presently contemplated, such profits were to be remitted or otherwise become subject to U.S. income tax, available tax credits would substantially reduce the amount of tax otherwise due.

Opinion of Independent Certified Public Accountants

Garlock Inc., its Shareholders and Directors:

We have examined the statements of consolidated financial position of Garlock Inc. and its consolidated subsidiaries as of December 30, 1973 and December 31, 1972 and the related statements of consolidated income and retained earnings and of changes in consolidated financial position for the fifty-two and fifty-three week periods then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Garlock Inc. and its consolidated subsidiaries at December 30, 1973 and December 31, 1972 and the results of their operations and the changes in their financial position for the fifty-two and fifty-three week periods then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Rochester, New York
February 18, 1974

Haskins & Sells

Ten Year Summary 1973-1964

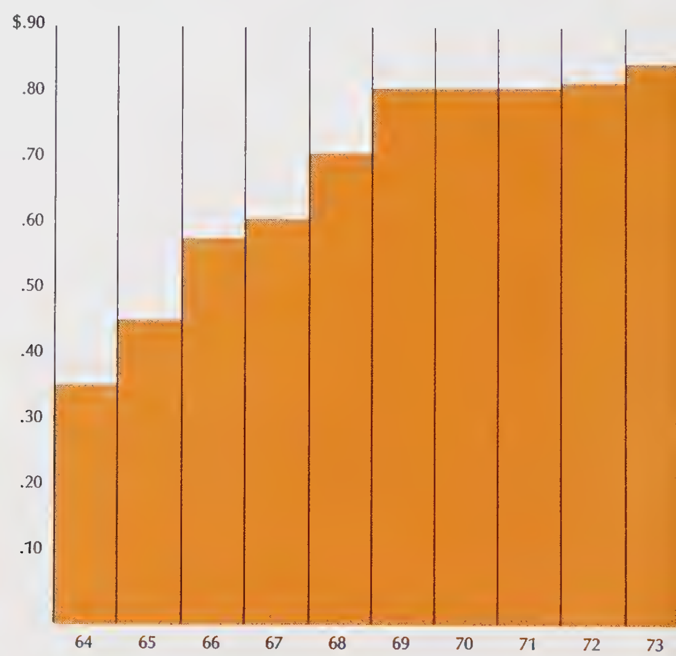
GARLOCK INC. AND CONSOLIDATED SUBSIDIARIES

(Years prior to 1972 restated to reflect pooling of Service Spring Company)

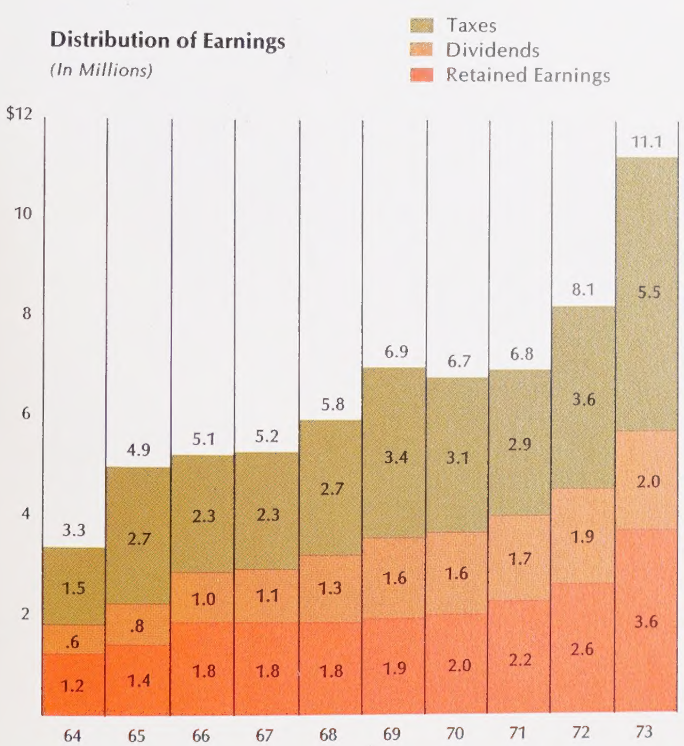
	1973	1972	1971
Income Statement Data			
*Sales	$ 126,022	$ 105,159	$ 87,650
*Earnings	5,592	4,513	3,925
Earnings per share	2.35	1.90	1.72
Dividends per share	.84	.81	.80
Financial Position Data			
*Current assets	$ 56,051	$ 46,258	$ 39,693
*Current liabilities	20,699	16,606	15,072
*Working capital	35,352	29,652	24,621
*Net property, plant and equipment	28,224	27,041	24,701
*Long-term debt	19,924	16,989	12,996
*Garlock shareholders' ownership	45,646	42,043	39,688
*Garlock shareholders' ownership per share	19.20	17.69	16.65
*Total borrowed capital	26,147	22,862	19,027
Other Data			
Average shares outstanding	2,376,929	2,379,532	2,277,330
Number of shareholders (year-end)	5,242	5,267	5,540
Number of employees (year-end)	5,915	5,397	5,031
*Earnings plus depreciation	$ 8,510	$ 7,226	$ 6,132
*Expenditures on new plant	$ 4,545	$ 5,162	$ 5,025
Net income to Garlock shareholders' ownership (beginning)	13.30%	11.37%	11.67%
Net income to sales	4.44%	4.29%	4.48%

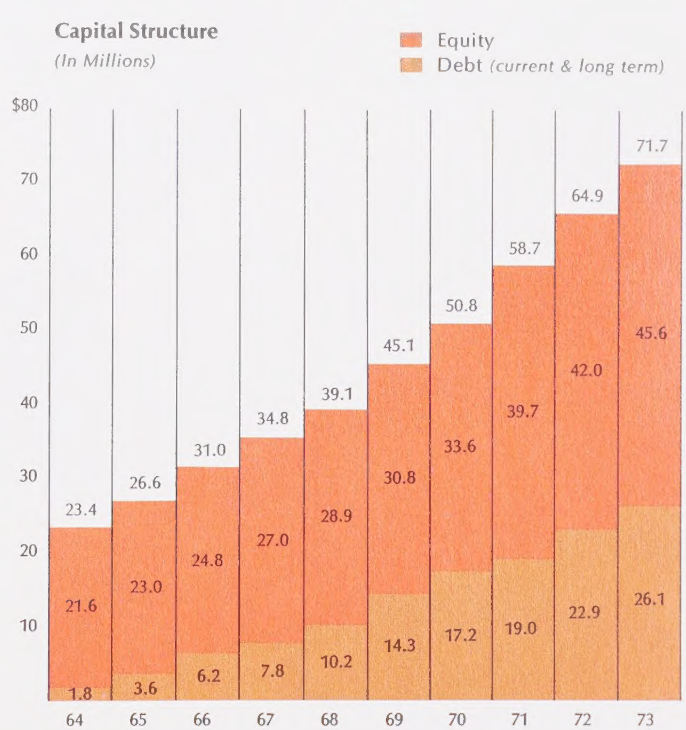
*Thousands of dollars

Dividends Per Share



1970	1969	1968	1967	1966	1965	1964
$ 78,533	$ 76,561	$ 66,139	$ 62,132	$ 60,533	$ 49,997	$ 39,910
3,597	3,505	3,167	2,899	2,793	2,262	1,791
1.73	1.68	1.54	1.46	1.44	1.17	.93
.80	.80	.70	.60	.575	.45	.35
$ 35,158	$ 32,398	$ 29,729	$ 25,283	$ 24,125	$ 22,218	$ 18,473
12,875	15,186	8,779	8,989	11,986	8,359	4,959
22,283	17,212	20,950	16,294	12,139	13,859	13,514
21,324	19,136	17,207	16,878	15,418	12,148	9,685
13,074	7,887	8,400	5,761	1,577	2,749	1,607
33,625	30,829	28,869	27,033	24,806	22,979	21,566
15.72	14.79	14.04	13.00	12.73	11.90	11.17
17,175	14,282	10,232	7,785	6,177	3,607	1,820
2,083,492	2,083,873	2,061,272	1,981,748	1,943,856	1,930,864	1,930,864
5,213	5,067	5,080	5,020	4,564	3,756	3,204
4,782	4,942	4,257	4,057	3,820	3,359	2,943
$ 5,421	$ 5,760	$ 5,259	$ 4,964	$ 4,495	$ 3,614	$ 2,999
$ 3,721	$ 4,132	$ 2,378	$ 2,864	$ 3,729	$ 1,731	$ 326
11.67%	12.14%	11.71%	11.69%	12.15%	10.49%	8.77%
4.58%	4.58%	4.79%	4.67%	4.61%	4.52%	4.49%





Operating Units

International Group

Garlock Benelux B. V.
Sliedrecht, Netherlands

Garlock Export Corporation
Palmyra, New York

Garlock International, Inc.
Palmyra, New York

Garlock de Mexico, S. A.
Mexico City, Mexico

Louis Mulas, Sucs., S. A.
Mexico City, Mexico

Woodville Rubber Company Limited
Ross-on-Wye, England
Burton, England

Arai Seisakusho Co., Ltd.
Tokyo, Japan

Garlock, S. A.
Panama, Republic de Panama
Zurich, Switzerland
Barcelona, Spain
Tokyo, Japan

Chromex, S. A.
Lardy, France

Garlock A.G.
Winterthur, Switzerland

Garlock GmbH
Dusseldorf, Germany (West)

Garlock (Great Britain) Ltd.
Newbury, England

Liard S. A.
Roux, Belgium

Liard France S. A.
Jeumont, France
Mourenx, France

Victor Engineering Pty. Limited
Sydney, Australia

Oil Seal Group

Precision Seal Division
Gastonia, North Carolina

Service Spring Company
Indianapolis, Indiana

Spring Division
Bristol, Connecticut

Stemco Manufacturing Company Inc.
Longview, Texas

Mechanical Products Group

Coatings Division
Austin, Texas
Palmyra, New York

Garlock of Canada Ltd.
Toronto, Ontario

Mechanical Rubber Division
Palmyra, New York

Mechanical Seal Division
Houston, Texas

Mechanical Power Group

Bearings Division
Cherry Hill, New Jersey

Coast-Winslow Filter Corporation
Hayward, California

France Packing of Canada Ltd.
Brantford, Ontario

France Products Division
Hayward, California
Newtown, Pennsylvania
Odessa, Texas
Philadelphia, Pennsylvania

Plastics Division
Camden, New Jersey

Plastomer Division
Newtown, Pennsylvania

Fluid Power Group

Fluid Power Limited
Rexdale, Ontario

Ortman-Miller Division
Hammond, Indiana

Directors

John N. Abell
Investment Banker
Wood Gundy Ltd.

Mortimer R. Anstice, Jr.
Investor

Ben H. Cook
President
Garlock Inc.

Burt N. Dorsett
Executive Vice President and Trustee
College Retirement Equities Fund

Donald A. Gaudion
Chairman and Chief Executive
Sybron Corporation

John I. Gearhart
Investor

A. J. McMullen
Chairman
Garlock Inc.

Richard L. Turner
Chairman and President
The Schlegel Manufacturing Co.

Herman H. Waggershauser
Director
Eastman Kodak Company

Schuyler C. Wells
Senior Investment Executive
Shearson, Hammill & Co., Incorporated

Officers

A. J. McMullen
Chairman and Chief Executive

Ben H. Cook
President

William R. Bow
Vice President—Administrative Services Group

John E. Brennan
Vice President—Mechanical Power Group

Donald J. Camille
Vice President—International Group

John J. Grady
Vice President—Finance Group

G. Parry Wiess
Vice President—Mechanical Products Group

Peter S. Hanke
Secretary and General Counsel

Robert E. Jeffery
Controller

Kenneth W. Smith
Treasurer

John D. Lynn
Assistant Secretary

Harold D. Retting
Assistant Secretary and Assistant Counsel

Clinton O. Steadman
Assistant Treasurer

Transfer Agents
Security Trust Company of Rochester
One East Avenue
Rochester, N.Y. 14604

Marine Midland Bank—New York
2 Broadway
New York, N.Y. 10015

Registrars
Lincoln First Bank of Rochester
Rochester, N.Y.

First National City Bank of New York
New York, N.Y.

Dividend Disbursing Agent
Security Trust Company of Rochester
One East Avenue
Rochester, N.Y. 14604

Independent Auditors
Haskins & Sells
Rochester, N.Y.

Stock Traded on
New York Stock Exchange
(Symbol—GAK)

Executive Offices
1250 Midtown Tower
Rochester, N.Y. 14604
(716) 232-1400
TELEX 978452

Annual Meeting
The annual meeting of shareholders will be held at 2:00 p.m. on Wednesday, April 24, 1974, in the Auditorium of the Marine Midland Bank—Rochester, One Marine Midland Plaza, Rochester, N.Y.

Garlock

Garlock Inc.
1250 Midtown Tower
Rochester, New York 14604